



DEPARTMENT OF DEFENSE

AUDIT REPORT

COLLECTION OF NONRECURRING COSTS FROM DOD CONTRACTORS
FOR COMMERCIAL SALES OF DEFENSE ARTICLES

No. 90-077

May 29, 1990

*Office of the
Inspector General*



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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-2884

May 29, 1990

MEMORANDUM FOR DEPUTY ASSISTANT SECRETARY OF DEFENSE
(PROCUREMENT)
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL
MANAGEMENT)

SUBJECT: Report on the Audit of the Collection of Nonrecurring Costs from DoD Contractors for Commercial Sales of Defense Articles (Report No. 90-077)

This final report, provided for your information and use, is part of our ongoing Audit of the Administration of Contractor Rental of DoD Plant Equipment and Collection of Nonrecurring Costs. Rental issues are being addressed in separate reports for each of the sites visited. This report is limited to the Collection of Nonrecurring Costs from DoD Contractors for Commercial Sales of Defense Articles. We made the audit from January through November 1989. The objectives of the audit addressed in this report were to determine whether nonrecurring costs were collected from DoD contractors who sell defense articles to commercial customers. We also evaluated the effectiveness of internal controls related to the collection of nonrecurring costs. DoD collected \$129 million of nonrecurring cost recoupment charges in FY 1988 for commercial and foreign military sales of defense articles.

This audit evaluated nonrecurring cost recoupment charges collections from four Army contractors selected during the audit survey. Additional sites were not selected for audit because Defense Acquisition Circular 88-5, effective May 1, 1989, changed the Defense Federal Acquisition Regulation Supplement procedures for collecting nonrecurring cost recoupment charges on commercial sales of defense articles. Since the effects of the changes will not be evident until time is allowed for implementation of the Circular, additional audit work was not warranted.

Two of the four audited contractors properly reported commercial sales of defense articles. The Army collected nonrecurring cost recoupment charges that were consistent with established charges in DoD guidance from the two contractors. However, the Army needed improvements in procedures for collection of nonrecurring cost recoupment charges. In addition, internal controls for the collection of the charges needed improvement. The DoD is implementing changes to the collection process that were established in Defense Acquisition Circular 88-5. These changes should improve the administration of collections of nonrecurring cost recoupment charges for

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commercial sales. The results of the audit are summarized in the following paragraphs, and the details and audit recommendations are in Part II of this report.

The Army collected nonrecurring cost recoupment charges from one contractor based on a recoupment charge established in 1971. The recoupment charge was not revised in a timely manner as required by DoD Directive 2140.2, "Recoupment of Nonrecurring Costs on Sales of U.S. Products and Technology," August 5, 1985. If the charge is not revised promptly, \$3.7 million may be lost over the next 5 years. In addition, the Army did not collect \$138,311 of nonrecurring cost recoupment charges for two contractors' commercial sales of defense articles. Finally, the U.S. Treasury incurred \$42,743 of interest expense due to untimely payments of the recoupment charges by two contractors. We recommended revising recoupment charges for defense articles produced by one contractor, collecting nonrecurring cost recoupment charges from two contractors, and developing guidance on collecting interest for untimely payments (page 5).

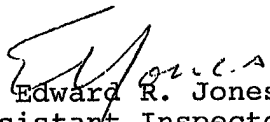
The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular No. A-123, and DoD Directive 5010.38. Adequate controls did not exist to ensure collection of proper nonrecurring cost recoupment charges or to ensure that collections were made in a timely manner on commercial sales of defense articles. Implementation of new collection procedures established in Defense Acquisition Circular 88-5 should correct these weaknesses. Therefore, no recommendations are made in this report to improve internal controls. A copy of the final report will be provided to senior officials responsible for internal controls within the Army for consideration in preparing the Army's annual internal control statement.

On March 7, 1990, a draft of this report was provided to the Deputy Assistant Secretary of Defense (Procurement) and the Assistant Secretary of the Army (Financial Management) for comments. As of May 7, 1990, the Deputy Assistant Secretary and the Assistant Secretary had not responded to the draft report. We request that the Deputy Assistant Secretary and the Assistant Secretary respond to the final report indicating concurrence or nonconcurrence with the finding, recommendations, potential monetary benefits, and internal control weaknesses described in this report. As required by DoD Directive 7650.3, the comments should indicate concurrence or nonconcurrence in the finding and each recommendation addressed to you. If you concur, describe the corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of

planned actions. If you nonconcur, please state your specific reasons. If appropriate, you may propose alternative methods for accomplishing desired improvements.

In order for your comments to be considered responsive, you must state concurrence or nonconcurrence with the estimated monetary benefits identified in Appendix E of \$3,811,825 for the collection of nonrecurring cost recoupment charges for contractors' commercial sales of defense articles. If you nonconcur with the monetary benefits or any part thereof, you must state the amount you nonconcur with and the basis for your nonconcurrence. Potential monetary benefits are subject to resolution in the event of nonconcurrence or failure to comment. We also ask that your comments indicate concurrence or nonconcurrence with the internal control weaknesses described above. DoD Directive 7650.3 requires that all audit recommendations be resolved within 6 months of the date of this final report. Accordingly, comments on the issues in this report should be provided within 60 days of the date of this memorandum.

The cooperation and courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. Michael Joseph on 202-693-0138 (AUTOVON 223-0138). Copies of the final report are being provided to the activities listed in Appendix H. A list of the audit team members is in Appendix G.


Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosure

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force
Director, Defense Acquisition Regulatory Council
Director, Defense Security Assistance Agency

REPORT ON THE AUDIT OF THE
COLLECTION OF NONRECURRING COSTS FROM DOD
CONTRACTORS FOR COMMERCIAL SALES OF DEFENSE ARTICLES

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Prepared by:
Financial Management Directorate
Project No. 9AC-0022

REPORT ON THE AUDIT OF THE
COLLECTION OF NONRECURRING COSTS FROM DOD
CONTRACTORS FOR COMMERCIAL SALES OF DEFENSE ARTICLES

PART I - INTRODUCTION

Background

DoD Directive 2140.2, "Recoupment of Nonrecurring Costs on Sales of U.S. Products and Technology," August 5, 1985, requires commercial purchasers of defense articles to pay a portion of the DoD nonrecurring cost of development and production of defense articles and technology. The Secretaries of the Military Departments are responsible for enforcing the collection program.

For commercial sales of major defense equipment, the Military Departments develop nonrecurring cost recoupment charges, the Defense Security Assistance Agency reviews and approves the charges, and contractors must pay the charge for each defense article sold. Major defense equipment is any item of significant combat equipment on the United States Munitions List having a nonrecurring research and development cost of more than \$50 million or a total production cost of more than \$200 million.

For nonmajor defense equipment, the Military Departments develop and approve the nonrecurring cost recoupment charges. Nonmajor defense equipment is any item of equipment or component that is not identified as major defense equipment.

Objectives and Scope

The objectives of the audit were to determine whether nonrecurring cost recoupment charges were collected from DoD contractors who sell defense articles to commercial customers. We also evaluated the effectiveness of internal controls related to collecting charges for commercial sales of defense articles.

We reviewed the collections of nonrecurring cost recoupment charges for commercial sales of defense articles at four contractor sites. A list of the four contractors is provided in Appendix A. We limited the number of sites visited because Defense Acquisition Circular 88-5, effective May 1, 1989, changed the procedures for collecting nonrecurring cost recoupment charges on commercial sales of defense articles. Additional audit work was not warranted at this time, since the effects of the changes will not be evident until time is allowed for implementation of the procedures.

We verified nonrecurring cost payments for commercial sales identified by the contractors. At two of the contractor sites visited, the payments verified were for commercial sales made from the date the current nonrecurring cost recoupment charges came into effect until the time of our audit. At one location,

we verified payments from the date a new charge was proposed by the Army. At another location, we verified payments for all commercial sales identified by the contractor, since the charge was not established until October 1988. The nonrecurring cost recoupment charges were established between March 1971 and October 1988 for the sales included in our audit.

This economy and efficiency audit was made from January through November 1989 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and accordingly, included such tests of internal controls as were considered necessary. A list of the activities visited or contacted is in Appendix F.

Internal Controls

We reviewed the program documentation and implementation of internal controls related to the collection of nonrecurring cost recoupment charges for contractors' commercial sales of defense articles. Specifically, we evaluated the control techniques in place to achieve the internal control objectives that contractors pay appropriate recoupment charges in a timely manner. We found that internal controls were not adequate to ensure collection of the appropriate recoupment charges from the contractors and to ensure that the collections were made in a timely manner. Implementation of new collection procedures established in Defense Acquisition Circular 88-5 should correct these weaknesses. Details of the identified weaknesses and new collection procedures established in the Circular are provided in Part II of this report.

Prior Audit Coverage

Five audit reports have been issued covering the collection of nonrecurring cost recoupment charges on commercial sales of defense articles. The following summary shows prior coverage by reporting organization. Details of the coverage and managements' actions are provided in Appendix B.

The General Accounting Office Report No. GAO/NSIAD-86-44 (OSD Case No. 6546), "Collecting Research and Development Costs on Commercial Military Sales," February 1986, recommended development of procedures to identify commercial sales of defense articles, designation of a Focal Point to monitor the commercial sales activity, development of dispute procedures, and changes in payment procedures to improve the timeliness of collections.

The Office of the Assistant Inspector General for Auditing, DoD, Report No. 89-087, "Contractor Rental of Government Real Property and Payment of Nonrecurring Costs," June 30, 1989, recommended collecting the nonrecurring cost recoupment charges from contractors for past and anticipated future sales, implementing additional guidance to clarify nonrecurring cost recoupment policies, and training contracting officers on the collection process.

The Army Audit Agency issued Report No. EC-89-201, "Foreign Military Sales Management, U.S. Army Tank-Automotive Command, Warren, Michigan," November 1, 1988; Report No. SO 89-200, "Foreign Military Sales Management, U.S. Army Missile Command, Redstone Arsenal, Alabama," December 20, 1988; and Report No. NE 89-206, "Foreign Military Sales Management, U.S. Army Communications-Electronics Command, Fort Monmouth, New Jersey," June 5, 1989, as part of an Army-wide audit of foreign military sales management. The recommendations included procedures for review and follow-up of export license applications to identify sales subject to nonrecurring cost recoupment charges. Specific recommendations were made at each of the sites where audit work was conducted.

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PART II - FINDING AND RECOMMENDATIONS

Recovery of Nonrecurring Costs on Commercial Sales of Defense Articles

FINDING

The Army did not collect the proper nonrecurring cost recoupment charges for contractors' commercial sales of defense articles. Additionally, nonrecurring cost recoupment charges were not collected in a timely manner. These conditions existed because the Army did not review or revise nonrecurring cost recoupment charges in a timely manner, and contracting officers were not familiar with DoD guidance on recovering nonrecurring costs. In addition, one of four contractors that we audited did not report commercial sales of defense articles to the DoD contracting officer. As a result of recoupment charges not being revised in a timely manner, recoupments from one contractor were based on a charge established in 1971. If corrective action is not taken promptly, we estimate that \$3.7 million of potential recoupments will be lost over the next 5 years. For two of the four contractors, the Army did not collect \$138,311 of nonrecurring cost recoupment charges on commercial sales of defense articles. Time periods for the collections varied by contractor (Appendix C). Additionally, late payments by contractors caused the U.S. Treasury to incur interest expense of \$42,743 (Appendix D).

DISCUSSION OF DETAILS

Background. DoD policy and guidance for assessing appropriate nonrecurring cost recoupment charges is provided in DoD Directive 2140.2, "Recoupment of Nonrecurring Costs on Sales of U.S. Products and Technology." The objective of the guidance is to ensure that commercial customers pay a fair price for the value of the DoD nonrecurring investment in the development and production of defense articles.

The nonrecurring cost recoupment charges for major defense equipment are calculated by prorating the nonrecurring development and production costs against estimated production quantities of the defense article. The recoupment charges for nonmajor defense equipment end items are calculated by multiplying the current DoD inventory price by 5 percent. The charges for major defense equipment are published in DoD Manual 5105.38, "Security Assistance Management Manual," and DoD Manual 7290.3, "Foreign Military Sales Financial Management Manual." The charges for nonmajor defense equipment are published in DoD Manual 7290.3.

DoD Directive 2140.2 requires that when contractors sell items substantially different (less than 90-percent common) from the defense article for which the recoupment charge was developed, the charge shall be assessed based on the commonality with the

defense article. For example, if the commercial derivative is 50-percent common with the DoD item, then 50 percent of the total charge for the DoD item will be assessed.

DoD Directive 2140.2 requires that all DoD contracts for research, development, test, and evaluation or acquisition of defense articles include a nonrecurring cost recoupment clause. The standard nonrecurring cost recoupment clause for contracts is DoD Federal Acquisition Regulation Supplement (DFARS) clause 252.271-7001, "Recovery of Nonrecurring Costs on Commercial Sales of Defense Products and Technology and of Royalty Fees for Use of DoD Technical Data," (previously DFARS clause 52.235-7002 and Defense Acquisition Regulation [DAR] clause 7-104.64[a]). The DFARS clause requires that the contractor notify the DoD Focal Point when commercial sales are made, obtain the nonrecurring cost recoupment charge, and make payments to the Government for each delivery of a defense article to a commercial customer. Payments from contractors for charges on sales of defense articles are deposited into the Miscellaneous Receipts Account of the U.S. Treasury.

The Defense Security Assistance Agency is responsible for reviewing and approving nonrecurring cost recoupment charges for major defense equipment items and for processing recoupment charge waiver requests received from foreign countries and international organizations for foreign military sales or direct commercial sales. The Comptroller of the Department of Defense provides cost accounting guidance for the collection process and ensures that a list of nonrecurring cost recoupment charges is published. The Office of the Under Secretary of Defense for Acquisition monitors the nonrecurring cost recoupment charges on sales of defense articles to domestic commercial customers.

Nonrecurring Cost Payments. Potential recoupments of \$2,410,773 for commercial sales by Boeing Helicopters (Boeing) were lost because the Army did not revise the nonrecurring cost recoupment charge for CH-47 helicopters. In addition, Saco Defense Incorporated (Saco) did not pay \$106,513 and Sanders Associates, Inc. (Sanders), did not pay \$31,798 of nonrecurring cost recoupment charges for commercial sales of machine guns and infrared countermeasure systems, respectively. Details of the potential and actual underpayments are in Appendix C. Textron Lycoming, Stratford Division, Subsidiary of Textron, Inc. (Textron), properly paid the nonrecurring cost recoupment charges for its sales of engines to commercial customers.

Boeing Helicopters. The nonrecurring cost recoupment charge for the Boeing CH-47 helicopter program does not reflect changes that have taken place in the program since the current charge of \$100,000 was established in 1971. The \$100,000 charge is for a CH-47 complete weapon system, including the nonrecurring cost recoupment charge for the engines and fiberglass rotor blades. Boeing pays \$93,600 of the charge, and the engine manufacturer pays \$6,400 for two engines installed on each

helicopter. DoD Directive 2140.2 requires each DoD Component to review major defense equipment charges annually to determine if significant changes have occurred in factors or assumptions used to compute the charges. When significant changes are identified or when a model change occurs, the DoD Component is to propose a new charge to the Defense Security Assistance Agency for approval.

The DoD has contracted for the modification of CH-47A/B/C model helicopters to CH-47D models. Although the U.S. Government is not purchasing new CH-47D models, Boeing is making commercial sales of derivatives of this helicopter. The U.S. Army Aviation Systems Command (AVSCOM) estimates that the commercial models CH-47-414-100 and 234 are 95-percent and 85-percent common to the Government model, respectively. These commonality figures are exclusive of the avionics package, which includes components of the helicopters. We were not able to determine the commonality including the avionics package and, therefore, used the above percentages in our calculations.

The AVSCOM indicated in a 1978 letter to Boeing that the nonrecurring cost recoupment charge for the CH-47 was going to change and that the new charge would probably be greater than \$100,000. However, in this letter, AVSCOM did not propose a new charge. Since 1980, AVSCOM has proposed two charges for the CH-47D helicopter. An AVSCOM proposal on July 25, 1980, would have increased the charge to \$159,759 (\$153,359 excluding the engine charge). In addition, on January 30, 1987, AVSCOM proposed to raise the charge to \$260,047 (\$253,318 excluding the engine charge). Neither of these rates was approved by the Defense Security Assistance Agency and, therefore, the charge remains at \$100,000.

Boeing contracted for and delivered 36 helicopters to commercial customers between the time of the July 25, 1980, charge proposal and November 15, 1989. The contractor paid \$3,088,800 of nonrecurring cost recoupment charges for the 36 deliveries. Although the two charges proposed by AVSCOM were not approved, additional payments of \$2,410,773 would have been due if those charges had been in effect. Details of this calculation are in Appendix C. We could not obtain contractor forecasts of commercial sales for 1990 through 1994. Of the 36 helicopters referenced above, 23 were sold and delivered during the past 5 years. If a similar number of helicopters are sold during the next 5 years and the recoupment charge is not revised promptly, an additional \$3.7 million of nonrecurring cost recoupment charges may not be collected. This calculation is based on the nonrecurring cost recoupment charge proposed in January 1987. Model 234 helicopters are not included in the calculation because those helicopters are no longer sold commercially. Details of our estimated monetary benefits calculation are in Appendix E.

The Defense Security Assistance Agency has indicated to AVSCOM through the U.S. Army Security Affairs Command that a building block approach (taking a CH-47A model to a D model) should be used to develop the new charge. Recent internal AVSCOM correspondence indicates confusion over what cost information is available and where that information may be located. Army headquarters should take an active role in resolving the issue to establish the proper recoupment charge to reflect DoD's current investment in nonrecurring costs.

Saco Defense Incorporated. We believe that Saco should pay the U.S. Government \$106,513 of nonrecurring cost recoupment charges for 5,252 machine guns sold commercially from January 1981 through January 1989. Details of the calculation are in Appendix C. Basic Ordering Agreements DAAA09-79-G-2005 and DAAA09-88-G-0018 between the U.S. Government and Saco contained appropriate DAR and DFARS clauses requiring the contractor to pay nonrecurring cost recoupment charges for its commercial sales of defense articles.

Saco manufactures the M-60 and M-2 machine guns, which are used by U.S. and foreign forces. In addition to the basic weapons, derivatives of each are sold commercially by Saco. The nonrecurring cost recoupment charge is \$32.00 for the M-60 machine gun and \$1.82 for the M-2 machine gun. Although the charges are published in DoD Manuals 5105.38 and 7290.3, contracting personnel at the U.S. Army Armament, Munitions and Chemical Command (AMCCOM), were unaware of the recoupment charges for the Saco produced items as published in the DoD manuals. Contractor personnel were aware that nonrecurring costs were to be paid to DoD, but were unsure of the amount to be paid and the payment procedures.

Contractor personnel reported in monthly letters, which stated the customer, the item sold, and the serial number for the commercial sales of the 5,252 machine guns to the Government. These letters were sent to the AMCCOM procuring contracting officer or the production specialist, but AMCCOM took no action to collect the proper nonrecurring cost recoupment charges.

Sanders Associates, Inc. Sanders did not pay \$31,798 of nonrecurring cost recoupment charges on commercial sales of 69 derivatives of the AN/ALQ-144 V1 infrared countermeasure weapon system. Contract DAAK20-83-C-0900 between the Army and Sanders included DAR clause 7-104.64. The clause requires the payment of nonrecurring cost recoupment charges for commercial sales of defense articles and also requires the contractor to notify the DoD contracting officer of the intention to sell defense articles or essentially similar items to commercial customers. The clause further requires that in the event the current charge is unavailable, the contractor will submit the information necessary to develop the charge.

Sanders personnel did not believe that their sales of infrared countermeasure systems were subject to nonrecurring cost recoupment charges, because the items sold were not exact replicas of the defense articles. Therefore, Sanders did not report commercial sales of defense articles or their derivatives to the DoD contracting officer to determine if payment of the charge was necessary.

Sanders manufactures infrared countermeasure weapon systems for aircraft, air defense radars, training and simulation systems, and other defense electronic weapon systems. The systems reviewed during our audit included the AN/ALQ-144 VE1 and AN/ALQ-144 VE2, infrared countermeasure weapon systems. These systems are commercially sold derivatives of the U.S. Government procured AN/ALQ-144 V1.

The nonrecurring cost recoupment charge, established on October 21, 1988, is \$608 for the AN/ALQ-144 V1. According to the Project Leader of the AN/ALQ-144 office at the Army Communications-Electronics Command (CECOM), the AN/ALQ-144 VE1 and AN/ALQ-144 VE2 are approximately 80-percent and 70-percent common with the AN/ALQ-144 V1, respectively. Therefore, the nonrecurring cost recoupment charge for the AN/ALQ-144 VE1 would be \$486.40 (\$608 times 80 percent), and the charge for the AN/ALQ-144 VE2 would be \$425.60 (\$608 times 70 percent).

We believe that Sanders should reimburse the U.S. Government \$31,798 for 40 AN/ALQ-144 VE1 and 29 AN/ALQ-144 VE2 systems sold commercially between February 1984 and December 1988. Although 61 of these units were sold before the recoupment charge was established, we do not believe this relieves the contractor of the contractual obligation to pay the nonrecurring cost recoupment charges.

Timeliness of Nonrecurring Cost Payments. Two contractors did not remit payments for nonrecurring cost recoupment charges on a timely basis. Since August 5, 1985, DoD Directive 2140.2 required that:

All DoD contracts for RDT&E [Research, Development, Test and Evaluation] or acquisition shall include a mandatory clause that requires the contractor to pay the USG [United States Government], within 30 days following delivery of each item from the contractor's facility or purchaser's acceptance (whichever comes first), the established NC [nonrecurring cost] recoupment charge for any domestic or international direct sale, coproduction, or licensed production of DoD-developed items or technology.

Before that time, there was no provision specifying a time limit for prompt payment of nonrecurring cost recoupment charges. Although the DoD Directive specifies the time limit, there was no similar provision in the Federal Acquisition Regulation (FAR) or

the DFARS until Defense Acquisition Circular 88-5, effective May 1, 1989, revised the DFARS to include the 30-day payment requirement. Contracting officers were unaware of the 30-day payment requirement for recoupment charges because the primary source of guidance for the contracting community is the FAR and the DFARS. The helicopter production contract DAAJ09-89-C-A010 between Boeing and the U.S. Government did not contain the 30-day payment requirement as specified in the DoD Directive. The contract required that Boeing submit nonrecurring cost recoupment charges 90 days after receipt of a customer's final payment so long as the terms for the final payment were no longer than 1 year after delivery. If longer payment terms existed, payment of the charges was to be made within 1 year after delivery. Similarly, the March 7, 1978, memorandum of agreement between Textron and AVSCOM did not contain the 30-day payment requirement. Instead, the contractor was required to pay nonrecurring cost recoupment charges within 90 days after the calendar quarter for items delivered during the quarter.

The U.S. Treasury incurred \$42,743 of interest expense due to delayed submissions of nonrecurring cost recoupment charges by Boeing and Textron. The payments were as much as 230 days late in relation to policy in the DoD Directive. Appendix D explains how we calculated the interest expense and provides the time frames and data used in the calculation.

Although the 30-day payment requirement is now included in mandatory DFARS contract clauses, we believe the requirement could be better enforced if the contractors were charged interest for late payments of the charges. Personnel from the Office of the Comptroller of the Department of Defense stated that the Debt Collection Act, Public Law 97-365, provides DoD the authority to collect interest on late payments of nonrecurring cost recoupment charges. The DFARS needs to be revised to provide procedures for the collection of interest on late payments of nonrecurring cost recoupment charges.

Recent Changes to DFARS and Related Audit Recommendations. Defense Acquisition Circular 88-5, effective May 1, 1989, changed the procedures for collecting nonrecurring cost recoupment charges on commercial sales of defense articles. The revision implements the policy and procedures contained in DoD Directive 2140.2 for establishing and collecting the recoupment charges. It also establishes a DoD Focal Point responsible for maintaining a central data base on the established charges for each of the Military Departments. The revision requires contractors to:

- determine if DoD has a scheduled nonrecurring cost recoupment charge for the article or technology being sold or transferred;

- provide the DoD Focal Point with commercial sales forecasts of articles and technology subject to a recoupment charge when required;

- notify the DoD Focal Point of all commercial sales, foreign or domestic, that are subject to a recoupment charge;

- pay the established recoupment charge to the DoD Focal Point within 30 days following delivery to or acceptance of the item by a purchaser, whichever comes first; and

- certify annually to the applicable DoD Focal Point that proper notification of all commercial sales subject to the collection of nonrecurring cost recoupment charges has been accomplished.

Office of the Assistant Inspector General for Auditing, Report No. 89-087, "Contractor Rental of Government Real Property and Payment of Nonrecurring Costs," June 30, 1989, recommended that the Military Departments provide training to contracting officers on the collection of nonrecurring cost recoupment charges. The report also recommended that the Military Departments establish procedures to verify that contracts issued before the revisions in Defense Acquisition Circular 88-5 contain collection instructions consistent with DoD Directive 2140.2 and references to recoupment charges as established in DoD Manuals 5105.38 and 7290.3. The Military Departments concurred with both recommendations.

Implementation of the Circular and the two recommendations should improve the administration of the collection of nonrecurring cost recoupment charges, correct deficiencies in the contracts, and improve internal controls. Accordingly, no further recommendations are being made to provide training to contracting officers, to modify existing contracts, or to develop additional internal controls.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Deputy Assistant Secretary of Defense (Procurement), Office of the Under Secretary of Defense for Acquisition, direct the Defense Acquisition Regulatory Council to revise the Defense Federal Acquisition Regulation Supplement to provide procedures for the collection of interest on payments of nonrecurring cost recoupment charges made later than the 30-day requirement included in the Supplement at Subpart 252.271-7001.

2. We recommend that the Department of the Army, Deputy Chief of Staff for Logistics develop:

- a. A nonrecurring cost recoupment charge for the CH-47D model helicopter.

- b. A nonrecurring cost recoupment charge for the modification of model CH-47A/B/C helicopters to CH-47D model helicopters.

3. We recommend that the Commander, U.S. Army Armament, Munitions and Chemical Command, establish an account receivable and collect \$106,513 from Saco Defense Incorporated for nonrecurring cost recoupment charges on commercial sales of M-60 and M-2 machine guns and their derivatives.

4. We recommend that the Commander, U.S. Army Communications-Electronics Command, establish an account receivable and collect \$31,798 from Sanders Associates, Inc., for nonrecurring cost recoupment charges on commercial sales of 40 AN/ALQ-144 VE1 and 29 AN/ALQ-144 VE2 infrared countermeasure weapon systems.

CONTRACTORS COVERED BY AUDIT

<u>Contractor</u>	<u>Location</u>	<u>PCO</u>	<u>ACO</u>
Boeing Helicopters	Philadelphia, PA	Army Aviation Systems Command	Army Plant Representative Office - Boeing
Textron Lycoming, Stratford Division, Subsidiary of Textron, Inc.	Stratford, CT	Army Aviation Systems Command	Defense Contract Administration Services Plant Representative Office - Textron
Saco Defense Incorporated	Saco, ME	Army Armament, Munitions and Chemical Command	Defense Contract Administration Services Management Area - Boston
Sanders Associates, Inc.	Nashua, NH	Army Communications-Electronics Command	Defense Contract Administration Services Plant Representative Office - Sanders

Acronyms used: PCO -- Procurement Contracting Officer
ACO -- Administrative Contracting Officer

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PRIOR AUDIT COVERAGE
SUMMARY OF INDIVIDUAL REPORTS

General Accounting Office Report No. GAO/NSIAD-86-44 (OSD Case No. 6546), "Collecting Research and Development Costs on Commercial Military Sales," February 1986, reviewed DoD procedures for identifying, monitoring, and collecting nonrecurring research, development, and production costs applicable to commercial sales licensed for export by the Departments of State and Commerce. The report stated that, although most nonrecurring costs associated with sales reviewed were collected, DoD was not aware of most commercial sales agreements between DoD contractors and foreign countries and could not ensure that recoupments of nonrecurring costs were collected. The report recommended development of procedures to identify non-Government sales of defense articles, designation of a Focal Point to monitor the commercial sales activity, development of dispute procedures, and changes in payment procedures to improve the timeliness of collections. DoD agreed with the intent of the recommendations and initiated actions to improve identifying, monitoring, and collecting nonrecurring costs.

Office of the Inspector General, DoD, Report No. 89-087, "Contractor Rental of Government Real Property and Payment of Nonrecurring Costs," June 30, 1989, addressed the collection of nonrecurring cost recoupment charges for commercial sales of defense articles. The report stated that DoD was not collecting the proper nonrecurring cost recoupment charges for contractors' commercial sales of defense articles. The report recommended collecting the nonrecurring cost recoupment charges from contractors for past and anticipated future sales, implementing additional guidance to clarify nonrecurring cost recoupment policies, and training for contracting officers on the collection process. The Military Departments generally concurred with the recommendations and initiated corrective actions.

Army Audit Agency Report No. EC 89-201, "Foreign Military Sales Management, U.S. Army Tank-Automotive Command, Warren, Michigan," November 1, 1988, stated that direct contractor sales of defense equipment to foreign countries were not adequately controlled and that potential recoupments on direct sales were not collected. The report recommended that follow-up action be initiated on the approval status of export license applications; that local procedures be revised to require follow-up action when requested payment schedules and other information necessary to monitor payment schedules and recoupments are not provided by contractors; and that suspense accounts be established in the financial records at the time an export license is sent to the major command recommending approval. Command agreed with the recommendations and stated that corrective actions had been taken.

PRIOR AUDIT COVERAGE
SUMMARY OF INDIVIDUAL REPORTS (Continued)

Army Audit Agency Report No. SO 89-200, "Foreign Military Sales Management, U.S. Army Missile Command, Redstone Arsenal, Alabama," December 20, 1988, stated that the procedures for recouping nonrecurring research, development, and production costs for major defense equipment were not effective in ensuring that the Government was properly reimbursed for sales. The report recommended that nonrecurring costs be recouped from DoD contractors for direct sales identified during the audit; the file of export license applications be reviewed and the State Department be contacted to identify additional sales subject to recoupment; recoupment action be taken on future export license applications received; and procedures be established to periodically contact Government representatives at the largest contractors for missile items to identify direct sales and ensure recoupment of Government costs. Command agreed with three of the four recommendations and stated that actions had or would be taken to implement the recommendations. However, Command did not agree with the recommendation to contact Government representatives at contractor facilities stating that it was not the Missile Command's responsibility to take these actions.

Army Audit Agency Report No. NE 89-206, "Foreign Military Sales Management, U.S. Army Communications-Electronics Command, Fort Monmouth, New Jersey," June 5, 1989, stated that the policies and procedures for recouping nonrecurring costs for direct sales of major defense equipment were not adequate. The report also stated that the amounts anticipated as collectible from direct sales were not adequately coordinated among Communications-Electronics Command activities. The report recommended that nonrecurring cost recoupment requirements be reemphasized to the Procurement Directorate. The report also recommended that accounting records for direct sales be periodically reconciled with the recoupment of nonrecurring cost report; that actions be initiated to collect nonrecurring costs from the contractor for direct sales of the AN/TPQ-36 Mortar Locating Radar; and that command establish a Focal Point for managing direct sales of major defense equipment. Command agreed with the finding and recommendations concerning direct sales of major defense equipment and initiated corrective actions. Command also agreed that the potential monetary benefits reported in the finding were reasonable.

NONRECURRING COST RECOUPMENT CHARGE UNDERPAYMENTS

Boeing Helicopters

CY of Delivery	Contract Date	Model No.	Quantity	Proposed NRC Per Unit	Per Unit NRC Paid Prior To Audit	Potential Underpayment Per Unit	Total Potential Underpayment
1989	Feb. 22, 1985	CH-47 414-100	8	\$153,359	\$93,600	\$ 59,759	\$ 478,072
1988	Feb. 24, 1987	CH-47 414-100	6	253,318	93,600	159,718	958,308
1988	Feb. 22, 1985	CH-47 414-100	4	153,359	93,600	59,759	239,036
1987	Feb. 22, 1985	CH-47 414-100	3	153,359	93,600	59,759	179,277
1987	Nov. 27, 1984	CH-47 414-100	2	76,680 ^{1/}	46,800	29,880	59,759
1986	Feb. 22, 1985	CH-47 414-100	2	153,359	93,600	59,759	119,518
1986	Nov. 27, 1984	CH-47 414-100	4	76,680 ^{1/}	46,800	29,880	119,518
1985	June 28, 1984	CH-47 234	3	130,355 ^{2/}	93,600	36,755	110,265
1983	Dec. 02, 1985	CH-47 234	2	130,355 ^{2/}	93,600	36,755	73,510
1983	Feb. 12, 1982	CH-47 234	<u>2</u>	<u>130,355 ^{2/}</u>	<u>93,600</u>	<u>36,755</u>	<u>73,510</u>
Total			<u>36</u>				<u>\$2,410,773</u>

Acronyms used:

NRC -- Nonrecurring cost recoupment charge

CY -- Calendar year

^{1/} Six CH-47 414-100 helicopters were sold to the Spanish Army, and a 50-percent waiver was granted by the Defense Security Assistance Agency (\$153,359 times 50 percent equals \$76,679.50. The amount is rounded to \$76,680 in the chart).

^{2/} Army Aviation Systems Command personnel determined the CH-47 234 helicopter to be 85-percent common to the CH-47D helicopter.

NONRECURRING COST RECOUPMENT CHARGE UNDERPAYMENTS (Continued)

Saco Defense Incorporated									
CY of Delivery	Model No.	Commonality Percentage	Quantity	Correct		Per Unit NRC		Underpayment Per Unit	Total Underpayment
				NRC Per Unit	Unit	Paid Prior To Audit	Paid Prior		
1989	M2HB	100	4	\$ 1.82		0		\$ 1.82	\$ 7.28
1989	M2HB w/QCB	85	59	1.55		0		1.55	91.45
1988	M2HB	100	90	1.82		0		1.82	163.80
1988	M2HB w/QCB	85	313	1.55		0		1.55	485.15
1987	M2HB	100	459	1.82		0		1.82	835.38
1987	M2HB w/QCB	85	1	1.55		0		1.55	1.55
1987	M2LW 50/50	50	1	.91		0		.91	.91
1986	M2HB	100	324	1.82		0		1.82	589.68
1986	M2HB w/QCB	85	1	1.55		0		1.55	1.55
1986	M2LW 50/50	50	10	.91		0		.91	9.10
1985	M2HB	100	132	1.82		0		1.82	240.24
1984	M2HB	100	206	1.82		0		1.82	374.92
1983	M2HB	100	75	1.82		0		1.82	136.50
1982	M2HB	100	273	1.82		0		1.82	496.86
Subtotal			<u>1,948</u>						<u>\$ 3,434.37</u>
1989	M60	100	148	\$32.00		0		\$32.00	\$ 4,736.00
1988	M60	100	95	32.00		0		32.00	3,040.00
1988	M60-E3	80	61	25.60		0		25.60	1,561.60
1987	M60	100	74	32.00		0		32.00	2,368.00
1987	M60-E3	80	320	25.60		0		25.60	8,192.00
1986	M60	100	1,085	32.00		0		32.00	34,720.00
1986	M60-E3	80	19	25.60		0		25.60	486.40
1985	M60	100	162	32.00		0		32.00	5,184.00
1985	M60-E3	80	12	25.60		0		25.60	307.20
1984	M60	100	631	32.00		0		32.00	20,192.00
1983	M60	100	263	32.00		0		32.00	8,416.00
1983	M60-E3	80	2	25.60		0		25.60	51.20
1982	M60	100	410	32.00		0		32.00	13,120.00
1981	M60	100	22	32.00		0		32.00	704.00
Subtotal			<u>3,304</u>						<u>\$103,078.40</u>
Total			<u>5,252</u>						<u>\$106,512.77</u>

Acronyms used: NRC -- Nonrecurring cost recoupment charge w/QCB -- M2HB machine gun with quick change barrel
CY -- Calendar year

NONRECURRING COST RECOUPMENT CHARGE UNDERPAYMENTS (Continued)

Sanders Associates, Inc.

CY of Contract Completion	Model No.	ALQ-144 V1 Commonality Percentage	Quantity	Correct NRC Per Unit	Per Unit NRC Paid Prior To Audit	Underpayment Per Unit	Total Underpayment
1989	AN/ALQ-144 VE1	80	17	\$486.40	0	\$486.40	\$ 8,268.80
1987	AN/ALQ-144 VE1	80	8	486.40	0	486.40	3,891.20
1986	AN/ALQ-144 VE1	80	9	486.40	0	486.40	4,377.60
1985	AN/ALQ-144 VE1	80	6	486.40	0	486.40	2,918.40
Subtotal			40				\$19,456.00
1988	AN/ALQ-144 VE2	70	9	\$425.60	0	\$425.60	\$ 3,830.40
1986	AN/ALQ-144 VE2	70	20	425.60	0	425.60	8,512.00
Subtotal			29				\$12,342.40
Total			69				\$31,798.40

Acronyms used: NRC -- Nonrecurring cost recoupment charge
CY -- Calendar year

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CALCULATION OF INTEREST EXPENSE INCURRED BY THE U.S. TREASURY

Interest expense of \$42,743 was incurred by the U.S. Treasury because of untimely payments of nonrecurring cost recoupment charges by two contractors. We did not calculate interest on sales for which no payments were made. The interest was computed on items that were contracted for and delivered after the effective date of DoD Directive 2140.2, "Recoupment of Nonrecurring Costs on Sales of U.S. Products and Technology," August 5, 1985. The Directive established the requirement to include a provision in contracts requiring payment of nonrecurring cost recoupment charges within 30 days after delivery or the purchaser's final acceptance, whichever comes first.

Pursuant to Section 11 of the Debt Collection Act of 1982, the Secretary of the Treasury establishes the Current Value of Funds Rate to be used in assessing interest charges for outstanding debts on claims owed to the Government. Our computations are based on simple interest and use the Current Value of Funds Rate (principal times rate times number of days late divided by 365). The principal is the nonrecurring cost recoupment charge. The number of days late is the period of time from 30 days after delivery to the date of payment. When the exact delivery date of an item was not known, we were able to determine the month and the year that the item was delivered. In these situations, we assumed the delivery date to be the middle of the month.

For Boeing Helicopters, we calculated that the Government incurred \$25,003 of interest expense due to late payments of nonrecurring costs recoupment charges on commercial sales of helicopters contracted for and delivered after August 5, 1985. The data used in the calculation is presented in the chart below. For Textron Lycoming, Stratford Division, Subsidiary of Textron, Inc. (Textron), we calculated that the Government incurred \$17,740 of interest expense due to late payments of nonrecurring cost recoupment charges on commercial sales of 266 engines contracted for after August 5, 1985, and delivered between January 1, 1987, and September 30, 1988. We did not calculate the interest expense incurred from commercial deliveries between August 5, 1985, and December 31, 1986, because of the large number of commercial deliveries. For a similar reason, the data used in the Textron calculation is not presented in this report, but will be provided under separate cover upon request.

CALCULATION OF INTEREST EXPENSE INCURRED BY THE U.S. TREASURY
(Continued)

Boeing Helicopters

<u>Serial No.</u>	<u>NRC Charge</u>	<u>Interest Rates</u>		<u>Days Late</u>		<u>Interest Incurred</u>
		<u>1988</u>	<u>1989</u>	<u>1988</u>	<u>1989</u>	
MP003/M4010	\$93,600	6.00	7.00	230	79	\$ 4,956.95
MP004/M4011	93,600	6.00	7.00	199	79	4,479.98
MP002/M4009	93,600	6.00	7.00	199	79	4,479.98
MP001/M4008	93,600	6.00	7.00	199	79	4,479.98
MP005/M4012	93,600	6.00	7.00	138	79	3,541.41
MP006/M4013	93,600	6.00	7.00	107	79	3,064.44
Total						<u>\$25,002.74</u>

**SUMMARY OF POTENTIAL MONETARY AND
OTHER BENEFITS RESULTING FROM AUDIT**

<u>Recommendation</u>	<u>Description of Benefit</u>	<u>1/</u>	<u>Amount of Benefit</u>
1.	Collection of interest on late payment of nonrecurring cost recoupment charges. This compliance category benefit will be recurring in nature.		Undetermined. We cannot predict the number or duration of late payments or the U.S. Treasury interest rate; therefore, we cannot quantify
2.a. and 2.b.	Collection of revised nonrecurring cost recoupment charges for future commercial sales of defense articles. This compliance category benefit will be recurring in nature.		\$3,673,514. <u>2/</u> Estimated additional collections over the next 5 years.
3.	Collection of nonrecurring cost recoupment charges for prior commercial sales of defense articles by Saco Defense Incorporated. This compliance category benefit is a one-time benefit.		\$106,512.77 <u>3/</u>
4.	Collection of nonrecurring cost recoupment charges for prior commercial sales of defense articles by Sanders Associates, Incorporated. This compliance category benefit is a one-time benefit.		\$31,798.40 <u>4/</u>
Total Estimated Monetary Benefits			\$3,811,825.17

1/ The interest collected is deposited in the U.S. Treasury's miscellaneous receipts account. The savings do not affect a specific DoD appropriation.

2/ See Appendix E, page 2 for details of this calculation.

3/ See Appendix C, page 2 for details of this calculation.

4/ See Appendix C, page 3 for details of this calculation.

**SUMMARY OF POTENTIAL MONETARY BENEFITS AND OTHER
BENEFITS RESULTING FROM AUDIT (Continued)**

Contractor	Model No.	Current NRC	January 1987 Proposed NRC	Potential Underpayment Per System	Forecast Sales Units	Total Potential Underpayment
Boeing Helicopters	CH-47D	\$93,600 <u>5/</u>	\$253,318 <u>6/</u>	\$159,718	23 <u>7/</u>	\$3,673,514 <u>8/</u>

Acronyms Used: NRC -- Nonrecurring cost recoupment charge
CY -- Calendar year

5/ Actual NRC is \$100,000 per system, of which \$6,400 is paid by the engine manufacturer for the two engines installed on the helicopter.

6/ Total proposed NRC was \$260,047, of which \$6,729 would be paid by the engine manufacturer for the two engines installed on the helicopter.

7/ The contractor did not provide a forecast sales unit figure. Therefore, we used the number of CH-47D helicopters contracted for and delivered during the period CY 1985 to CY 1989.

8/ The total potential underpayment is calculated using an underpayment of \$159,718 per system. Although not all potential underpayments during the prior 5 years would be \$159,718, potential future underpayments will be based on a newly established recoupment charge. For our calculations, we used the January 1987 charge proposed by the Army to the Defense Security Assistance Agency.

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Office of the Assistant Secretary of Defense (Production and Logistics), Washington, DC
Deputy Assistant Secretary of Defense (Logistics), Washington, DC
Deputy Assistant Secretary of Defense (Procurement), Washington, DC
Office of the Comptroller of the Department of Defense, Directorate of Accounting Policy, Washington, DC

Department of the Army

Office of the Assistant Secretary of the Army (Research, Development and Acquisition), Washington, DC
Office of the Deputy Chief of Staff for Logistics, Directorate for Security Assistance, Washington, DC
Army Materiel Command, Alexandria, VA
Army Armament, Munitions, and Chemical Command, Rock Island, IL
Army Aviation Systems Command, St. Louis, MO
Army Plant Representative Office, Boeing Helicopters, Philadelphia, PA
Army Communications-Electronics Command, Fort Monmouth, NJ
Army Security Affairs Command, Alexandria, VA

Department of the Navy

Naval Office of Technology Transfer and Security Assistance, Alexandria, VA

Defense Agencies

Defense Contract Audit Agency, Alexandria, VA
Defense Contract Audit Agency Field Offices:
Resident Office, Bath Iron Works, Bath, ME
Resident Office, Sanders Associates, Inc., Nashua, NH
Resident Office, Textron Lycoming, Stratford, CT
Branch Office - Valley Forge, King of Prussia, PA
Defense Logistics Agency, Alexandria, VA
Defense Contract Administration Services Region, Boston, MA
Defense Contract Administration Services Management Area, Boston, MA
Defense Contract Administration Services Plant Representative Office, Sanders Associates, Inc., Nashua, NH
Defense Contract Administration Services Region, New York, NY
Defense Contract Administration Services Plant Representative Office, Textron Lycoming, Stratford, CT
Headquarters, Defense Security Assistance Agency, Washington, DC

ACTIVITIES VISITED OR CONTACTED (Continued)

Non-Government Activities

Boeing Helicopters, Philadelphia, PA
Saco Defense Incorporated, Saco, ME
Sanders Associates, Inc., Nashua, NH
Textron Lycoming, Stratford Divison, Subsidiary of Textron, Inc.,
Stratford, CT

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Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
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